Remarks of Commissioner Linda K. Breathitt
Federal Energy Regulatory Commission

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"Crisis and Chaos: Energy Markets and the New Economy"
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Good afternoon! I am delighted to join you today to talk about "Energy Markets and the New Economy" – although I am somewhat uneasy with the "Crisis and Chaos" part of your program! It has been quite a year, including enough crisis and chaos already. But I do not intend to dwell on those elements today, and I hope a look toward the future will provide a better context for enjoying today's luncheon.

The events in California and the West over the past year and a half have challenged all of us to take a new look at market restructuring and take stock of where we are going. We have all asked ourselves the same questions: Can a restructured electric industry sustain itself? Will the developing electric markets achieve the objective of fair and efficient competition? Will consumers and politicians have the resolve and patience to allow competitive markets to develop?

The turmoil that has been experienced in certain electric markets has not succeeded in derailing the Commission's effort to open the markets to competition. I believe it is fair to say that our resolve in pursuing wholesale competition is stronger than ever; but the California situation was (and continues to be) an education for all of us, and we will go forward having learned some important lessons about market restructuring. All of us are older and wiser now.

Some of the lessons we have learned have remained prominent in my own reflections, and I am sure they will guide me in the important decisions that lie ahead. First, regulators and policymakers must give consumers honest and realistic expectations about the potential costs and benefits of electric restructuring. Second, it is imperative to maintain a reasonable supply reserve margin. Third, we must focus on the task of expanding and enhancing the transmission grid. Fourth, utilities and load-serving entities must be allowed to hedge in forward markets. Fifth, price responsive demand-side programs must be implemented. And finally, I am convinced that FERC must improve its programs for market oversight and enforcement.

When the Commission issued Order No. 2000 two years ago to establish an approach to foster Regional Transmission Organizations (RTOs), I believed - and continue to believe - that RTOs would be an effective means to remove barriers and impediments present in wholesale electricity markets. RTO implementation is more or less a "given" at this point. The questions are when and how many. This past July, the Commission issued a series of RTO orders that caused a bit of a firestorm. In those orders, the Commission directed the formation of four RTOs. I issued a partial dissent on this aspect of the orders. My concern was that this decision on RTO formation did not take into account several important elements: Order No. 2000's voluntary approach; our state colleagues' views on this new configuration; and the inherent difficulty of timing and complexity of merging markets. In addition, I was not comfortable with the decision on how many RTOs there must be. Although some are impatient with the pace of RTO development, Order No. 2000 has fostered the development of RTOs in every region of the country. Interested parties, including many of you in the room today, have devoted considerable time and resources to see that RTOs get up and running.

My observation is that the Commission is reaching the conclusion that a thoughtful and measured approach may, in the long run, result in faster and better RTO development. Recent public discussions with my colleagues indicate that there may, indeed, be some flexibility in RTO scope and timing. I favor RTOs reflecting large regional markets, but I have no preconceived view on precisely how many RTOs there should be to accomplish the fundamental goals of Order No. 2000. And while I do not wish to prolong a difficult transition, I believe we need to take the time to do it right. As Chairman Greenspan recently testified with regard to measures to stimulate the economy, "While there is an obviously very strongly desired sense to move rapidly, it's far more important to be right than quick."

Last month, the Commission adopted a new plan for a transition to fully functioning RTOs. The transition can be described as two parallel tracks: one to get RTOs up and running, and the other to address business and process issues. On the first track, the Commission is processing the results of mediations that took place in the Northeast and Southeast, and the Spring 2001 MISO/Alliance settlement. At yesterday's public Commission meeting, the Commission heard presentations from staff setting forth the issues to be resolved and their recommendations.

In a nutshell, here is where we are in the various regions: The Commission soon will need to provide guidance to the parties in the Northeast and Southeast mediations. In the Northeast, the primary concerns relate to governance and market design, and the participants have placed several models on the table for our consideration. In the Southeast, the biggest issues arise from the strong presence of public power and from fears of cost shifts where prices are already low. State commissions in the Southeast don't think we have done a sufficient job of cost/benefits analysis, and I agree.

In the Midwest, the Midwest ISO is capable of assuming operational control of transmission facilities by December 15, 2001, and the Commission is working hard to issue the necessary orders and approvals for that to occur. It is possible that the Alliance could be operational soon thereafter; but there remain some concerns about seams between the MISO and Alliance, as well as questions concerning which functions are appropriately assigned to a for-profit transco. On this, let me say that I hope the Commission does not foreclose the possibility of a stand-alone independent transmission company. I am not ready to give up on the transco model. Finally, in the West, it looks like we will continue to have three RTOs in the short run. I continue to believe it is best not require a single West-wide RTO at this time. Stay tuned.

On the second track in the RTO implementation effort, the Commission has embarked on a process to seek answers to the substantive questions of how RTOs should accomplish the functions and characteristics of Order No. 2000. The original objective was to initiate an FPA section 206 rulemaking on market design and market structure. I think it is still very much up in the air, however, whether the result will be a pro forma tariff crafted by the Commission, or a set of guidelines under which RTO participants can propose individual tariffs.

The first phase of this effort was "RTO Week," which took place during all of last week. The Commission led a series of workshops, in which we discussed necessary market information, congestion management, cost recovery, market monitoring, transmission planning, business and reliability standards, the nature of transmission rights, demand-side programs, and state/federal cooperation.

During RTO week, we heard from state public utility commissioners and experts from many industry sectors, covering the spectrum of viewpoints on how to structure RTOs. Last week's sessions amounted to a marathon conference, and I am still trying to digest all of what we heard from the industry. But much of it boils down to striking the appropriate balance between standardization of "best practices" and flexibility to accommodate regional differences in order to create efficient, seamless markets. I do not wish to oversimplify this task, because I anticipate it will be a very contentious and complicated one. It is made even more difficult by the fact that markets across the country are in various stages of RTO development. But I will tell you up front that I am not a "one-size-fits-all" regulator, and never have been.

I recognize that standardization across all RTOs can provide certainty and transparency for market participants – but at what cost? I believe an approach that provides guidance and strong principles, with flexibility in implementation, will result in the best choices, as long as we take care not to allow regional differences to turn into seams issues. My goal will be to allow markets to benefit from innovation, so I will be leery of too prescriptive an approach. I also believe we can recognize regional differences in RTO market design. That said, however, I foresee that FERC will be under pressure to keep this process fairly short so as to avoid regulatory uncertainty.

I couldn't help but notice on your conference brochure that one of the issues to be addressed is who has regulatory authority now, and who will have it in the future - and particularly, (and I am quoting directly from the brochure) "Will the State PUCs be FERCed over?" After sitting around a table last week with 29 state commissioners as part of our "RTO Week" program, I can tell you that state commissioners are not about to be "FERCed" - not without a fight, anyway. I must acknowledge that a rift has developed between state and federal regulators over the RTO process. Many state commissioners feel that they have not had an opportunity for meaningful participation in the decisionmaking. They also have called for a better demonstration of the benefits of RTOs, particularly to low-cost states.

I heard the messages, and I believe my colleagues did, too. We can do better at working cooperatively with state commissions. All of us - federal regulators, state regulators, and the industry - need a win our staff is in , and we need it together. FERC can do a better job at cost/benefit analysis, and we are in the process of updating the analysis we used for Order No. 2000, with a regional look. This is critical to getting buy-in, especially in the Southeast, where low-cost power is readily available. We can work to ensure that cost shifts are kept to a bare minimum, and we should better explain the cost shifts that may not be avoidable.

At yesterday's Commission meeting, we discussed a plan to help us forge better relationships with state PUCs by setting up regional advisory panels. The Commission asked staff to devise a plan for working with states on RTO implementation details. At the next Commission meeting, on November 7, staff will present a proposal to the Commission for our approval. I stated at the meeting yesterday that I would support a process that is not overly formal or that will require great expenditures from state commissions, and that I believe NARUC should be involved in the development of panels and the assignment of duties to the panels. I hope the result will be stronger relationships with state commissions.

Apart from RTO formation, there are other aspects to restructuring interstate electricity markets that are on our minds these days. One of them is developing a standard interconnection agreement and procedures that would be available to all public utilities under the Federal Power Act. To this end, the Commission is considering an Advance Notice of Proposed Rulemaking (ANOPR) that floats the idea of a standard interconnection agreement and procedure based on the ERCOT model, as supplemented by various "best practices" approved by the Commission in individual cases. The Commission intends for staff to hold a series of public meetings in an attempt to develop a consensus on a standard interconnection agreement and procedures, which will eventually culminate in a Notice of Proposed Rulemaking. I am advocating that the Commission pursue cost issues separately. I support this approach because I believe that issues surrounding cost responsibility for interconnections will be the most contentious, and may take longer to resolve. I therefore think it is best not to hold up implementation of standard procedures pending resolution of the cost issues.

I would like to make a few remarks about transmission siting since the expansion of the transmission grid is critical to competitive markets. On several occasions, I have recommended to Congress that FERC be granted federal eminent domain authority similar to the authority the Commission exercises with respect to the siting of interstate natural gas pipelines under the Natural Gas Act. The Commission could build into its implementation of such legislation procedures to ensure cooperation by the states and regional participation in siting decisions. I believe this centralized approach has become necessary from an efficiency standpoint, and will result in less bureaucracy and more timely decisions for transmission providers and customers. I am aware that ELCON also advocates that FERC be given such authority, and I could not resist preaching to the choir just a little bit. I would like to add, however, that I am not advocating that FERC should have siting authority for electric distribution lines or power plants. I believe state governments are best positioned to make those decisions.

I had just a brief opportunity to glance through ELCON's report - or as it was described to me, ELCON's "encyclopedia" - "Preventing Market Failures on the Road to Competition." One theme that appears in the document jumped out at me because it echoes what I have been telling my federal and state colleagues for some time: that regulators <u>must</u> take it upon themselves to ensure that the public has <u>realistic</u> expectations about the transition to competition and the costs and benefits of restructuring. I think we end up hampering our own efforts when we promise lower prices in order to garner political support for our pro-competitive policies. As we have been reminded by our state colleagues, we must be honest in detailing the costs and benefits of our actions. Only then can we be effective in collaborating with the public and the industry to develop regulatory policies that achieve the ultimate goals of restructuring: reliability, just and reasonable prices, innovative technologies and services, and protection against the exercise of market power.

Thank you.